

Message Text

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ACTION EUR-12

INFO OCT-01 EA-09 NEA-10 IO-13 ISO-00 EURE-00 SSO-00
NSCE-00 USIE-00 INRE-00 SP-02 AID-05 EB-08 NSC-05
SS-15 STR-04 OMB-01 CEA-01 CIAE-00 FRB-01 INR-07
NSAE-00 XMB-04 OPIC-06 LAB-04 SIL-01 L-03 H-02 PA-02
PRS-01 ABF-01 /118 W
-----161939Z 065118 /43

O R 161811Z MAR 77
FM AMEMBASSY LONDON
TO TREASURY DEPT WASHDC IMMEDIATE
SECSTATE WASHDC IMMEDIATE 1612
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY DUBLIN
AMEMBASSY NEW DELHI
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY TOKYO
AMCONSUL BELFAST
AMCONSUL EDINBURGH
USMISSION EC BRUSSELS
USMISSION OECD PARIS
USDEL MTN GENEVA
USDOC WASHDC

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DEPARTMENT PASS FEDERAL RESERVE BOARD

TREASURY FOR DONALD E. SYVRUD, OASIA

E.O. 11652: N/A
TAGS: ECON, UK
SUBJECT: ECONOMIC DEVELOPMENTS FOR PERIOD MAR. 10 - 16

SUMMARY: INDUSTRIAL AND MANUFACTURING PRODUCTION AND RE-
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TAIL SALES INCREASE SLOWLY. CENTRAL GOVERNMENT BORROWING
IS BELOW FORECAST TREND. THE PARLIAMENTARY EXPENDITURE
COMMITTEE CRITICIZES PROPOSED CUTS IN PUBLIC SECTOR CAPI-
TAL EXPENDITURE. THE GOVERNMENT REAFFIRMS ITS INTENTION
NOT TO NATIONALIZE THE CLEARING BANKS. IMPORTS FALL AND
CURRENT BALANCE GOES INTO SURPLUS. STERLING HAS BEEN
STRONG IN FOREIGN EXCHANGE MARKETS. END SUMMARY.

1. INDUSTRIAL PRODUCTION. INDUSTRIAL PRODUCTION ROSE IN JANUARY. THE OVERALL INDEX OF INDUSTRIAL PRODUCTION (1970 EQUALS 100) INCREASED BY 1.0 PERCENT TO 103.9 FROM A REVISED 102.9 IN DECEMBER. SLIGHTLY NARROWER IN ITS COVERAGE, THE INDEX OF MANUFACTURING PRODUCTION ROSE BY 0.7 PERCENT TO 104.4 FROM A REVISED 103.7 IN DECEMBER. WHILE OVERALL INDUSTRIAL OUTPUT HAS GROWN BY 2.5 PERCENT SINCE JANUARY 1976, THE ANNUALIZED RATE OF INCREASE OVER THE PAST THREE MONTHS WAS 4.3 PERCENT. THIS SLIGHT QUICKENING IN THE RATE OF OUTPUT IS DUE ENTIRELY TO SHARP RISES IN "MINING AND QUARRYING" AND "GAS, ELECTRICITY AND WATER" WHICH TOGETHER COMPRISE 11 PERCENT OF THE INDEX. WEIGHTIER ELEMENTS SUCH AS ENGINEERING, METAL AND OTHER MANUFACTURING HAVE SHOWN LITTLE CHANGE OVER THE PAST THREE MONTHS WHILE "FOOD, DRINK AND TOBACCO" AND "CHEMICALS, COAL AND PETROLEUM PRODUCTS" HAVE SHOWN DECLINING LEVELS OF OUTPUT.

ON A MARKET SECTOR BASIS, CONSUMER AND INVESTMENT GOODS INDUSTRIES HAVE SHOWN LITTLE CHANGE IN THEIR PRODUCTION LEVELS OVER THE PAST 6 MONTHS. VIRTUALLY ALL OF THE UPWARD IMPETUS HAS COME FROM INTERMEDIATE GOODS INDUSTRIES WHOSE OUTPUT HAS RISEN 7 PERCENT SINCE LAST JULY.

2. CENTRAL GOVERNMENT BORROWING REQUIREMENT. WITH FEBRUARY RESULTS AVAILABLE, FINANCIAL TRANSACTIONS DATA FOR THE FIRST 11 MONTHS OF THE FISCAL YEAR (FY 76/77) ARE COMPLETE. THEY INDICATE THAT THE CENTRAL GOVERNMENT BORROWING REQUIREMENT (CGBR) HAS DECLINED BY 2.83 BILLION UNCLASSIFIED

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POUNDS OR 37.9 PERCENT WHEN COMPARED WITH THE FIRST 11 MONTHS OF FY 75/76. THE FOLLOWING TABLE SUMMARIZES BOTH THE FEBRUARY AND YEAR-TO-DATE FIGURES:

POUNDS MILLIONS

1976-77 1 APRIL -

BUDGET 28 FEBRUARY FEBRUARY

CONSOLIDATED FUND FORECAST 1976 1977 1976 1977

REVENUE 33.197 27,008 30,958 2,591 2,765

EXPENDITURE 39.915 32'602 35,186 2,903 3,173

DEFICIT MET FROM

THE NATIONAL LOANS

FUND -6,718 -5.594 -4,228 - 312 . 408

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-----161940Z 065203 /42

O R 161811Z MAR 77
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AMCONSUL EDINBURGH
USMISSION EC BRUSSELS
USMISSION OECD PARIS
USDEL MTN GENEVA
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OTHER NATIONAL LOANS

FUND TRANS-
ACTIONS (1)
RECEIPTS 4,900 3,136 3,745 230 345
PAYMENTS 8,932 5,482 4,724 461 194
TOTAL NET BORROW.
ING BY THE NATION-
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AL LOANS FUND -10,750 -7,940 -5,207 . 543 - 257
OTHER FUNDS AND
ACCOUNTS 324 482 578 18 306
CENTRAL GOVERNMENT

BORROWING REQUIRE-

MENT .10,426 7.458 4.629 561 - 563

- (1). EXCLUDING NATIONAL DEBT AND OTHER TRANSACTIONS CONCERNED WITH THE FINANCING OF THE BORROWING REQUIREMENT.

THE SMALLER CGBR DERIVES LARGELY FROM THE HIGHER THAN ANTICIPATED REVENUES FLOWING FROM MORE RAPID THAN EXPECTED PRICE INCREASES. IN ADDITION, THE EXPENDITURE CONTROL SYSTEM BASED ON CASH LIMITS COVERING ABOUT TWO-THIRDS OF CENTRAL GOVERNMENT EXPENDITURE HAS APPARENTLY SUCCEEDED IN HOLDING EXPENDITURE TOTALS TO THEIR PLANNED LEVELS. FINALLY BORROWING FROM THE CENTRAL GOVERNMENT BY LOCAL AUTHORITIES AND PUBLIC CORPORATIONS HAS FALLEN SHARPLY. IT HAD BEEN ANTICIPATED THAT SUCH BORROWING WOULD AMOUNT TO 4.03 BILLION POUNDS DURING FY 77. IN THE EVENT, LOCAL AUTHORITIES, NATIONALIZED INDUSTRIES AND OTHER PUBLIC CORPORATIONS HAVE BORROWED 0.82 BILLION POUNDS DURING THE FIRST 11 MONTHS OF FY 76/77. NOT ALL OF THIS SHORTFALL REPRESENTS LOWER SPENDING. SINCE THESE BODIES HAVE BORROWED FROM OTHER SOURCES DURING THE FISCAL YEAR, INCLUDING BORROWING FROM ABROAD UNDER THE EXCHANGE COVER SCHEME.

3. RETAIL SALES. PRELIMINARY ESTIMATES INDICATE A SMALL RISE IN RETAIL SALES VOLUME IN FEBRUARY. THE INDEX OF RETAIL SALES VOLUME (1971 EQUALS 100) STOOD AT 107.5, A RISE OF 0.3 PERCENT FROM ITS JANUARY LEVEL OF 107.2. FOR THE PAST TWO MONTHS FINAL REVISIONS HAVE REDUCED THE PRELIMINARY ESTIMATE. THIS HAS CONFIRMED THE RATHER FLAT TREND IN SALES SINCE LAST NOVEMBER WHEN VOLUME ROSE IN ANTICIPATION OF AN INCREASE IN VALUE ADDED TAX. OVER THE PAST THREE MONTHS, RETAIL SALES VOLUME HAS DECLINED BY UNCLASSIFIED

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1.6 PERCENT. HOWEVER AVERAGE VOLUME FOR THE FIRST TWO MONTHS OF 1977 IS VIRTUALLY UNCHANGED FROM THE LEVEL ACHIEVED DURING THE FIRST QUARTER OF 1976. THE DECLINE IN RETAIL SALES VOLUME MAY PRESAGE A DROP IN REAL CONSUMER EXPENDITURE FOR THE FIRST QUARTER OF 1977.

4. PUBLIC EXPENDITURE WHITE PAPER. AFTER SEVERAL DAYS OF HEARINGS ON THE RECENT PUBLIC EXPENDITURE WHITE PAPER, THE PARLIAMENTARY EXPENDITURE COMMITTEE ISSUED A REPORT WHICH TOOK STRONG ISSUE WITH THE DEEP CUTS IN CAPITAL EXPENDITURE PLANNED OVER THE NEXT TWO FISCAL YEARS. THE COMMITTEE NOTED THAT WHILE CURRENT EXPENDITURE ON GOODS, SERVICES AND TRANSFER PAYMENTS WAS SLATED TO RISE BY 0.7 PERCENT (0.31 BILLION POUNDS) BETWEEN FY 76/77 AND FY 78/79, CAPITAL SPENDING WILL DECLINE BY 18.4 PERCENT (1.29 BILLION POUNDS) OVER THE SAME PERIOD. THE COMMITTEE

STATES THAT "THE GOVERNMENT IS THUS ITSELF ACTING LIKE THOSE INDUSTRIALISTS IT CRITICIZES FOR FAILING TO INVEST. INDEED, EVEN WORSE, IT APPEARS TO BE CUTTING CAPITAL EXPENDITURES AND SELLING OFF PRODUCTIVE CAPITAL ASSETS (E.G. BRITISH PETROLEUM SHARES) IN ORDER TO SUSTAIN CURRENT EXPENDITURE, THE CLASSIC ACTION OF AN AILING INDUSTRIAL COMPANY." HOWEVER THE COMMITTEE DID NOT PLACE FULL BLAME ON HMG FOR THE COMPOSITION OF THE SPENDING CUTS, NOTING THAT CUTS IN CURRENT EXPENDITURE WOULD HAVE REQUIRED LEGISLATION WHOSE PASSAGE MIGHT HAVE BEEN DIFFICULT TO GUARANTEE GIVEN THE CURRENT POLITICAL COMPOSITION OF THE PARLIAMENT. THE COMMITTEE CONCLUDES THAT "ELECTORAL RESULTS SUCH AS THOSE OF 1974 CARRY THEIR CONSEQUENCES AND THIS (THE CUT IN CAPITAL SPENDING) IS ONE OF THEM."

5. NATIONALIZATION OF THE CLEARING BANKS WAS AGAIN REJECTED BY THE GOVERNMENT DURING A PARLIAMENTARY EXCHANGE ON MARCH 14 BETWEEN HAROLD LEVER. CHANCELLOR OF THE DUCHY OF LANCASTER, AND MR. ERIC HEFFER, A MEMBER OF LABOUR.S NATIONAL EXECUTIVE COMMITTEE. LEVER REAFFIRMED THAT NA-
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TIONALIZATION OF THE BANKS DOES NOT FORM PART OF GOVERNMENT POLICY AND FORECAST THE GOVERNMENT WILL BE ABLE TO CONTINUE TO REGARD THE PROPOSAL AS "IRRELEVANT TO OUR PURPOSES " LEVER ADDED LABOUR PARTY POLICY ON THE ISSUE WILL HAVE TO BE DECIDED BY THE USUAL DEMOCRATIC PROCESS

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PRS-01 ABF-01 /118 W

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O R 161811Z MAR 77

FM AMEMBASSY LONDON
TO TREASURY DEPT WASHDC IMMEDIATE
SECSTATE WASHDC IMMEDIATE 1614
INFO AMEMBASSY BONN
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BUT INDICATED HE WOULD BE AS RESOLUTE IN OPPOSING NATION-
ALIZATION AS LEFT WINGERS ARE IN ADVOCATING IT. HEFFER
REPLIED THERE IS OBVIOUSLY GOING TO BE A TREMENDOUS POLI-
TICAL FIGHT TO GET HIS CASE OVER.

6. THE FEBRUARY VISIBLE TRADE DEFICIT FELL 343 MILLION
POUNDS TO 189 MILLION POUNDS. THIS IMPROVEMENT, WHICH
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WAS SUFFICIENT TO RAISE THE ESTIMATED CURRENT ACCOUNT
BALANCE TO A 31 MILLION POUND SURPLUS' RESULTED FROM AN
EXTRAORDINARY 380 MILLION POUND DECLINE IN THE VALUE OF
IMPORTS. (SEE LONDON 4228.)

7. SHORTTERM INTEREST RATES CONTINUED TO MOVE DOWNWARD
DURING THE WEEK. ON THURSDAY, MARCH 10' THE BANK OF ENG.
LAND ACKNOWLEDGED THATTHE MINIMUM LENDING RATE (MLR)
WHICH IT HAD SET AT 12 PERCENT WAS OUT OF LINE WITH MAR-
KET FORCES. THE BANK BY FIAT REDUCED MLR TO 11 PERCENT
AND FRIDAY'S TREASURY BILL AUCTION CONFIRMED THIS LEVEL.
IN THE SENSE THAT HAD THE TRADITIONAL FORMULA BEEN USED
TO CALCULATE MLR, THE RESULT WOULD HAVE AGREED WITH THE
SET RATE.

ON THE SAME DAY THE MAJOR CLEARING BANKS BEGAN TO CUT
THEIR BASE LENDING RATES FROM 11-1/2 OER CENT TO 10 1/2
PERCENT AND BRANCH DEPOSIT RATES FROM 8 TO 6-1/2 PERCENT.
THE BUILDING SOCIETIES WHOSE RESOURCES HAD BEEN PINCHED
LAST FALL AS THEIR DEPOSIT RATES STOOD MUCH BELOW THE
CLEARING BANKS' DEPOSIT RATES HAVE FOUND THEIR RESOURCES

GROWING ONCE MORE. AS A RESULT CUTS IN CLEARING BANK DEPOSIT RATES SHOULD HELP INCREASE MORTGAGE FUNDS. AVAILABILITY AND PERHAPS REDUCE MORTGAGE RATES AS WELL.

THE RECENT FALL IN INTEREST RATES PARTICULARLY SHORT TERM INTEREST RATES, HAS BEEN CONSIDERABLE, AS MAY BE SEEN IN A COMPARISON OF REPRESENTATIVE RATES OVER THE LAST SIX WEEKS:

STERLING INTERBANK RATES: FEB 1 MAR. 8 MAR 15

1 MONTH	12-13/16	11.15/32	10-5/16
3 MONTHS	12-5/16	111/8	10 1/4
6 MONTHS	11-11/16	10.7/8	10-1/4

GILTS:

TREASURY 12 PERCENT 1983	12.36	11.44	10.86
TREASURY 13-3/4 PERCENT 1993	14.17	13.34	13.31

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TREASURY 15.1/2 PERCENT 1998 14.50 14.40 13.73

THE CAPITAL GAIN OF HOLDING SHORT-TERM INSTRUMENTS OVER THIS SIX-WEEK PERIOD IS AROUND 15 PERCENT AT ANNUAL RATE. SUCH A RETURN IS SUFFICIENT TO OVERCOME COSTS OF FORWARD FOREIGN EXCHANGE COVER. NETTING AROUND A 7 PERCENT COVERED RETURN. THUS WHILE MONEY MARKET INSTRUMENTS STILL HAVE COVERED YIELDS THAT ARE LOWER THAN EURODOLLAR DEPOSITS. CAPITAL GAINS PROSPECTS ARE SUFFICIENT TO ATTRACT FOREIGN FUNDS.

MARKET SOURCES BELIEVE THAT THE GOVERNMENT BROKER HAS RECENTLY BEEN SUPPLYING "UNOFFICIAL TAP STOCKS," (WHICH ARE SIMPLY THE SALE OF GILTS OUT OF BANK OF ENGLAND INVENTORY ACCOUNTS RATHER THAN OF RECENTLY ISSUED GILTS). THESE SALES, THOUGHT TO HAVE AMOUNTED TO ABOUT 100 MILLION POUNDS DURING THIS LAST WEEK, MAY HAVE BEEN MADE TO OFFSET ANY INCREASE IN THE MONEY AGGREGATES RESULTING FROM FOREIGN CAPITAL INFLOWS.

8. STERLING HAS HAD A VERY GOOD WEEK, WITH BANK OF ENGLAND LEANING AGAINST THE WIND AND TAKING IN LARGE AMOUNTS OF FOREIGN CURRENCY, WHICH MARKETS ESTIMATE AT SEVERAL HUNDRED MILLION DOLLARS. MARKET HAS TENDED TO IGNORE BAD NEWS. AS LEYLAND UNREST. FALL IN MLR WAS EASILY DIGESTED AS FORWARDS RESPONDED BY NARROWING. THESE FACTORS COUPLED WITH BETTER TRADE FIGURES. LEAD SOME OBSERVERS TO BELIEVE BANK OF ENGLAND MAY ALLOW RATE TO RISE TO \$1.72 - \$1.73 LEVEL.

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9. EXCHANGE RATE AND GOLD

EFFECTIVE EX-			
DATE	EXCHANGE RATE (\$)	CHANGE RATE (PERCENT)	GOLD (\$)
3/9	1.7185	62.0	146-5/8
3/10	1.7155	61.9	146.5/8

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3/11	L.7185	62.0	1461/8
3/14	1.7195	62.0	144-7/8

3/15 1.7190 62.0 146-5/8
 CHANGE 3/8-3/15 UP 0.0015 UP 0.1 UNCHANGED

10. FORWARD DISCOUNT ON STERLING

DATE	1 MONTH	3 MONTHS	6 MONTHS
3/9	1.15	3.20	6.05
3/10	1.05	2.92	5.82
3/11	1.02	2.92	5.70
H 3/14	1.10	2.95	5.57
3/15	1.00	2.75	5.45

CHANGE 3/8-3/15 NARROWED 0.22 NARROWED 0.52 NARROWED 0.87
 (ALL FIGURES IN CENTS)

11. EURODOLLAR INTEREST RATES

DATE	1 MONTH	3 MONTHS	6 MONTHS
3/9	45/8 5	5-1/2	
3/10	4-7/8	5-1/8	5-5/8
3/11	5-1/8	5-1/8	5-5/8
3/14	4-11/16	5-1/8	5-1/2
3/15	4 7/8	5-1/8	5-1/2

CHANGE 3/8-3/15 UNCHANGED UNCHANGED UNCHANGED

12. THREE-MONTH LONDON INTERBANK - EURODOLLAR INTEREST RATE DIFFERENTIAL

DATE	
3/9	6-1/2
3/10	6
3/11	5-17/32
3/14	5-11/16
3/15	5-1/8

CHANGE 3/8-3/15 NARROWED 7/8

13. STERLING CERTIFICATES OF DEPOSIT

DATE	1 MONTH	3 MONTHS	6 MONTHS
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3/9	11-13/32	10.61/64	10-3/4
3/10	10-25/32	10-9/16	10-37/64
3/11	1011/16	109/16	10 37/64
3/14	10-13/32	10-11/32	10-11/32
3/15	10-3/16	10-3/16	10-5/16

CHANGE 3/8-3/15 DOWN 17/32 DOWN 7/16 DOWN 1/2

L4. THE MINIMUM LENDING RATE WAS REDUCED TO 11 PERCENT IN A BANK OF ENGLAND ANNOUNCEMENT THURSDAY, MARCH 10, A FALL OF 1 PERCENT FROM THE RATE SET BY THE BANK ON FEBRUARY 3. THE TREASURY BILL RATE FELL BY 0.3665 PERCENT TO 10.3011 PERCENT AT FRIDAY'S TREASURY BILL AUCTION AS THE 300 MILLION POUNDS OF BILLS TENDERED ATTRACTED BIDS OF 999.95 MILLION POUNDS. AS THE FORMULA WOULD THUS

IMPLY AN MLR OF 11 PERCENT. THE BANK OF ENGLAND NOTED
THAT THE FORMULA HAD BEEN REACTIVATED. THIS WEEK A TEN-
DER OF 300 MILLION POUNDS WILL REPLACE A LIKE AMOUNT OF
MATURING BILLS. SPIERS

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Subject: ECONOMIC DEVELOPMENTS FOR PERIOD MAR. 10 - 16 SUMMARY: INDUSTRIAL AND MANUFACTURING PRODUCTION AND RE-
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TAGS: ECON, UK
To: TRSY STATE
Type: TE
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